

Before the
Federal Communications Commission
Washington DC 20554

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Federal Communications Commission
Office of Secretary

In the Matter of)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)

Comments of Time Warner Communications Holdings, Inc.

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David R. Poe
Catherine P. McCarthy
Yvonne M. Coviello
LeBoeuf, Lamb, Greene
& MacRae, LLP
1875 Connecticut Avenue, NW
Suite 1200
Washington, DC 20009

Economic Consultants:
Susan M. Baldwin
Helen E. Golding
Lee L. Selwyn
Economics and Technology, Inc.
One Washington Mall
Boston, MA 02108

Paul B. Jones
Donald F. Shepheard
Janis A. Stahlhut
Time Warner Communications
Holdings, Inc.
300 First Stamford Place
Stamford, CT 06902-6732

Dated: December 19, 1996

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SUMMARY

The Federal-State Joint Board's Recommended Decision ("RD")¹ reflects the strenuous efforts of the Joint Board to resolve the many difficult issues associated with universal service reform, particularly in conforming to the dictates of the Telecommunications Act of 1996,² and Time Warner Communications Holdings, Inc. ("TW Comm") by and large is supportive of those efforts. However, several key issues necessary to the successful implementation of the universal service goals outlined in the Telecommunications Act of 1996 are not resolved by the Federal-State Joint Board's Recommended Decision. Further, some of the Joint Board's recommendations appear to be inconsistent with other recommendations. For these reasons, TW Comm urges the Federal Communications Commission ("Commission") to exercise its plenary authority and thoroughly analyze the underlying issues before implementing the recommendations made by the Joint Board.

Specifically, the Commission must consider the following issues before implementing the Joint Board's

¹ In the Matter of Federal-State Joint Board on Universal Service, Recommended Decision, CC Docket No. 96-45 (released November 8, 1996) (hereinafter "Recommended Decision").

² Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (to be codified at 47 U.S.C. § § 151 et seq.) (hereinafter "1996 Act").

recommendations: (1) consideration of the interaction of federal proposals with existing state universal service programs that rely on intrastate revenues; (2) determination of whether interstate or intrastate revenues constitute the appropriate revenue base for assessing contributions to support high-cost and low-income assistance; (3) development of competitive bidding for schools and libraries; and (4) consideration of the appropriate level of high-cost support.

TW Comm also suggests that the Commission consider certain issues at greater length in order to implement a workable revenue benchmark. In order to design an effective revenue benchmark the following must be considered: 1) including all revenues inextricably linked to basic telephone service within the revenue benchmark; 2) computing two distinct revenue-based thresholds to recognize ILECs' unique access to revenues from yellow pages; 3) choosing a national or a state benchmark only after analyzing the manner in which the burden of high-cost support is to be spread; 4) assessing the relative merits of freezing the revenue benchmark; and 5) other criteria that should be used to target the distribution of high cost support.

In addition, the Commission must resolve several issues regarding universal service subsidies designated for schools and libraries. It is imperative that the Commission consider state

programs that generate internal subsidies to fund programs that currently provide schools with telecommunications services offered at discounted rates before establishing a discount. The Commission must also take steps to ensure that the annual cap on spending of universal service funds designated for schools and libraries is set at a reasonable level that accounts for all the discounted services recommended by the Joint Board. Only after the Commission resolves all of the outstanding issues regarding universal service funding will it be possible for the Commission to establish an appropriate and reasonable annual cap on spending.

⁶ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (to be codified at 47 U.S.C. § § 151 et seq.)

supportive of those efforts. The RD provides the Federal Communications Commission ("FCC" or "Commission") with significant guidance regarding the implementation of the goals of Section 254 of 1996 Act. However, many of the Joint Board's recommendations are not entirely clear and some of the recommendations that are clearly stated appear to be inconsistent with other recommendations. In addition, the RD leaves several key issues unresolved. At least in part, these shortcomings may be attributable to the Joint Board's difficulty in reaching a consensus among the different interests represented before it. Nonetheless, the Commission must complete an independent and thorough analysis of the underlying issues before implementing the RD's proposals.

At a minimum, the Commission's efforts must harmonize the most significant of the RD's inconsistencies, clarify those recommendations that are not readily interpretable, and make decisions regarding those unresolved issues that are central to reaching universal service objectives. Implementing the RD's proposed policies without addressing the inconsistencies, ambiguities and omissions that currently exist in the proposed policies is likely to result in unworkable universal service solutions. Accordingly, in these comments, TW Comm seeks to

(hereinafter "1996 Act").

identify some of the portions of the RD that must be addressed at the Commission level in order to achieve universal service goals.

Because Section 254 of the 1996 Act requires the Commission to institute a Federal-State Joint Board under Section 410(c), 47 U.S.C. § 410(c), the Commission possesses plenary authority to implement Section 254.⁷ Pursuant to Section 410(c) of the Communications Act of 1934, a Joint Board convened at the Commission's request prepares a recommended decision "for prompt review and action by the Commission."⁸ In the context of Section 410(c), "prompt review and action" has not been construed to be a Congressional mandate for mere implementation of the Joint Board's recommendations without further consideration by the Commission of the underlying issues. Rather, consistent with principles of reasoned decision making and its enabling statute, the Commission may substitute its own policy judgments for those

⁷ Arguably, a Joint Board convened under Section 410(c) possesses very limited authority, only those powers conferred upon an examiner or administrative law judge. 47 U.S.C. § 410(a). Section 410(a) refers expressly to Section 3105 of Title 5, the section governing the appointment of administrative law judges. 5 U.S.C. § 3105. The Commission's regulations indicate that the Commission's final decision - issued following consideration of a hearing examiner's conclusions - includes both findings of fact and conclusions as well as the reasons or bases for those conclusions, upon all the material issues of fact, law or discretion presented on the record. See 47 C.F.R. § 1.282(b)(1).

⁸ 47 U.S.C. § 410(c).

of the Joint Board. Thus, the Commission possesses the inherent authority to reconcile apparent contradictions within the RD and to create the consistent policies necessary to achieve the goals of Section 254.

II. Implementation

The RD appears to suggest that many of the issues necessary for the Commission to implement the Joint Board's recommendations are resolved by the RD. However, the RD fails to provide adequate resolution of vital decisions that must be made prior to the implementation process. These include, but are not limited to, the following: A) consideration of the interaction of federal proposals with existing state universal service programs that rely on intrastate revenues; B) a determination of whether interstate or intrastate revenues constitute the appropriate revenue-base for assessing contributions to support high-cost and low-income assistance; C) development of competitive bidding for schools and libraries programs; and D) consideration of the appropriate level of high-cost support. The Commission must explore these issues in further detail before it implements the Joint Board's recommendations.

A. The federal mandate under Section 254 to provide for universal service takes precedence over state universal service policies that rely on intrastate revenues.

Before implementing the Joint Board's RD, the Commission should consider how to minimize disruption to existing state programs that rely on intrastate revenues to promote universal service goals. TW Comm supports the Commission's basic conclusion that Section 254's mandate gives the FCC primary responsibility to implement universal service protections that are consistent and uniform nationally, thus taking precedence over the efforts of the individual states to achieve similar goals. However, federal universal service mechanisms must reflect the fact that many states base a carrier's universal service support level upon a carrier's total intrastate revenue, including revenues over which the state exercises no jurisdiction. The rationale for the states' approach is that some of these are revenues derived from vertical services which have, as their platform, both basic local telephone service and the name recognition associated with the incumbent provider. Many state public utility commissions include revenues received from non-regulated subsidiaries in incumbent rate case proceedings to calculate universal service support.⁹

⁹ As discussed below, for example, many states impute yellow pages revenues as part of universal service support.

In the Interconnection proceeding, the Commission expressly recognized the validity of state universal service funding mechanisms that are equitable and nondiscriminatory.

[S]tates may not, therefore, include universal service support funding in the rates for elements and services pursuant to sections 251 and 252, nor may they implement mechanisms that have the same effect. For example, states may not fund universal service support by imposing higher rates for interconnection, unbundled elements, or transport and termination on carriers that offer service to different types of customers or different geographic areas Nothing in the 1996 Act or this Order, however, precludes a state from adopting a universal service funding mechanisms, whether interim or otherwise, if such funds are collected in accordance with section 254(f) on an 'equitable and nondiscriminatory basis' through specific, predictable, and sufficient mechanisms that do not rely on or burden Federal universal service support mechanisms.¹⁰

In consideration of the fact that state universal service funding mechanisms do exist, as well as the Commission's express recognition of their validity, it may be prudent to allow for some period of transition so that states can appropriately adjust

Without explicitly recognizing this state support mechanism and adapting either the state or federal program accordingly, ILECs will be overcompensated.

¹⁰ Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98 at para. 713 (released August 8, 1996), petition for review pending sub nom., Iowa Utilities Board et. al v. FCC, No. 96-3321 and consolidated cases (8th Cir. filed Sept. 6, 1996) (emphasis added).

state universal service funding mechanisms to the new federal program. For example, since the federal funding mechanism provides for the recovery of costs on an unseparated basis (in some cases recovering the full difference between the cost proxy and average revenue-per-line), states must evaluate the extent to which existing programs overlap to avoid providing for the same services. Implementation of the Joint Board's recommendation in 1998 should allow sufficient time for such evaluation and implementation of necessary modifications.

B. Both interstate and intrastate revenues constitute the appropriate revenue base for assessing contribution to support high-cost and low-income assistance.

In assessing contribution to interstate telecommunications carriers for funding the Joint Board's recommendation with respect to schools and libraries, the Joint Board recommended that the Commission base contributions on both interstate and intrastate revenue. However, with respect to the revenue-base for high-cost and low-income assistance, the Joint Board deferred to the Commission, recommending that it seek additional comment. In so doing, the Joint Board stated that "the decision as to whether intrastate revenues should be used to support the high-cost and low-income assistance programs should be coordinated with the establishment of the scope and magnitude

of the proxy-based fund, as well as with state universal service support mechanisms."¹¹

With all due respect to the difficult decisions and compromises required of the Joint Board, TW Comm agrees with the members of the Joint Board who supported assessment for high-cost and low-income programs on both interstate and intrastate sources of revenue. There is no rationale for assessing contribution to support subsidies to schools and libraries on a different revenue-base than that relied on to assess contribution for high-cost and low-income assistance. The same broad-based funding needs for meeting national policy goals apply under both programs. The statute reflects express Congressional intent that all universal service assistance is a matter of national policy objectives, which should be broadly funded by all telecommunications carriers. The RD concluded that assessing contributions for schools and libraries based on both interstate and intrastate revenues best meets the Congressional national policy objectives. The fact that the magnitude of the high-cost/low-income fund has not yet been determined does not in any way alter the validity of applying that policy conclusion to high-cost and low-income assessment programs.

¹¹ Recommended Decision at para. 817.

The RD also suggested that the difference between the average revenue-per-line benchmark and the per-line cost, based on the cost-proxy model eventually adopted by the Commission, should be funded by the interstate universal service fund ("USF"). Thus, if a certain area's revenue-per-line is greater than the national average and less than its proxy costs, the difference will be fully funded by the USF. The Joint Board specifically seeks comment on whether the intrastate nature of the services being funded has a significant bearing in determining whether the intrastate revenues of interstate carriers should be included in the assessed revenue-base.¹²

It is simply illogical to extend federal funding to intrastate services at a level that will far exceed that which historically has been funded, while restricting the assessment of such support to the much smaller base of interstate-only revenues. This would result in continuing to allocate the vast majority of the funding burden to a single class of telecommunications carrier. Further, those interstate carriers which derive a much larger share of their revenue from intrastate services, principally incumbent local exchange carriers ("ILECs"), would be responsible for a smaller share of support for intrastate services than other carriers (most likely

¹² Id. at para. 822.

including their competitors). This scenario raises serious questions as to whether such a policy can satisfy the competitive neutrality principle established in the Joint Board's RD.

Finally, administration of the USF would be more efficient if assessment were based on both interstate and intrastate sources of revenue. While the Joint Board declined to consider separately administered funds for schools and libraries versus high-cost and low-income assistance, separate bases for contributions to portions of the fund would create unnecessary complications. Additionally, as noted in the Joint Board's RD, as carriers begin to offer more packaged offerings consisting of intrastate and interstate services, it may become increasingly difficult for carriers, and less auditable for regulators, to distinguish between jurisdictional sources of revenue.¹³

For all of the above reasons, TW Comm urges the Commission to establish a revenue-base that includes both interstate and intrastate sources of revenue.

C. Competitive bidding should be relied on to provide services to schools and libraries.

In order to receive discounts under the Joint Board's recommendation, qualifying schools and libraries must submit requests for services to the fund administrator, who then

¹³ Id. at para. 317.

electronically posts the service descriptions and specifications to provide all parties interested in providing such services with the opportunity to submit a bid in response to the "request for proposal" ("RFP"). Since this process will be central to the selection of service providers for schools and libraries, it is critical that the RFP process be designed in a way that assures competitive neutrality and attracts the optimum response from potential service providers. Toward that end, any competitive bidding mechanism must include the option for market participants to bid separately to provide telecommunications services or Internet services. This will extend the opportunity to participate to those providers which can supply some but not all of the services, and thereby increase the opportunity that RFPs will produce lower-cost, quality services that minimize the impact on funding. Allowing responses only from providers that can offer packaged services will limit service provision to the major telecommunications companies and exclude companies that could potentially offer more innovative and/or lower-cost services. Moreover, companies that submit bids for all services must do so in a way that allows the school or library making the RFP to evaluate the cost of receiving the unbundled services from different service providers.

- D. **As a fundamental matter, the FCC should reject outright the exaggerated claims of need for high-cost support, which is entirely unjustified based upon the levels of competition that exist today.**
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The FCC should carefully consider the timing of the establishment of any new high-cost mechanism before it implements such a fund. There are two critical issues to consider with respect to timing. First, the levels of high-cost support currently under consideration are excessive, anticompetitive, and unjustified. Second, at present, price cap companies do not need high-cost support, and thus, the FCC should reject the provision of high-cost support to such carriers.¹⁴

If the Commission allows price cap companies to draw from a high-cost fund - contrary to TW Comm's recommendation - it should evaluate the timing of such a withdrawal in terms of its effect upon the development of competition. Presently,

¹⁴ As discussed in TW Comm's comments in this proceeding, price cap or other forms of incentive regulation provide ample flexibility and earnings opportunities to permit internal funding of universal service obligations. Pricing flexibility, ease in introducing new services, entrance into new lines of business, and increased earnings opportunities are the principle tools of accommodating competitive risk. There is no reason for new entrants to subsidize unprecedented ILEC earnings. While incentive regulation provides ILECs with an opportunity, universal service support should not be a vehicle to guarantee increased LEC earnings. They must be required to take some risks for all these new opportunities. As a safety net, however, ILECs could petition state commissions with a full demonstration that their universal service obligations are not allowing them to earn a fair return.

ILECs' earnings are healthy, and there is simply no evidence to suggest that their revenue streams are imminently jeopardized.¹⁵ As a long-term policymaking matter, it is important to establish a USF that reflects the potential for competitive inroads in the local market. However, it is anticompetitive to create a USF today that operates as a make-whole subsidy for ILECs. The USF that ILECs seek is predicated upon a vision of local competition that simply does not yet exist and is not likely to exist in the near future. Thus, there is a grave danger that the day the "new" high-cost fund is implemented, ILECs will receive a huge windfall, potentially in the billions of dollars.

Interexchange carriers currently fund something less than \$1-billion of high-cost support. Accordingly, there is a net transfer of this amount to all ILECs (including rural ones). Despite this, the ILECs now seek to obtain an even larger transfer in the new USF environment. However, neither the costs the ILECs will face in 1998 (or whenever the new high-cost funding mechanism is established) nor the revenues they will receive will differ significantly from the ILEC costs and revenues of today. In other words, ILECs would have the

¹⁵ Actions such as the Eighth Circuit stay of the Commission's Interconnection order suggest that ILEC revenues will likely be sheltered from competitive erosions for some time.

regulators believe that in 1998 they will need billions of dollars more in high-cost funding than they currently receive simply because competition may eventually exist. Such portrayals of the ILECs' financial future are belied both by strong current earnings and by the persistent willingness of investors to pay significant premiums over book value for ILEC stock.

III. Revenue-Based Benchmark

The Joint Board recommends the use of nationwide average revenues-per-line as the benchmark for determining the amount of high-cost support that should be available for eligible carriers. TW Comm agrees that the use of a revenue-based benchmark to compute high-cost support, if implemented correctly, would be competitively neutral and economically efficient. The national benchmark would be compared with the cost yielded by a proxy model in order to determine the need for, and level of, high-cost support. However, because the two contending cost proxy models¹⁶ compute costs at a far more granular level than at the national aggregate, under the proposal described by the Joint Board, national average revenues would likely be compared with

¹⁶ See BCM2 and the Hatfield Model. See Appendix F of the RD.

cost results that are disaggregated well below even the state level.¹⁷

The Joint Board identified and rejected two alternative benchmarks — (1) average rates and (2) relative cost. Each of these two alternative benchmarks has been adopted for use in state universal service proceedings. For example, the Vermont Public Service Board adopted average rates for its state USF program,¹⁸ and the California Public Utilities Commission adopted relative cost as the benchmark in its recent decision.¹⁹ TW Comm concurs with the Joint Board that a rate-based benchmark might ignore the revenues from a customer that contribute to the cost

¹⁷ Theoretically, under either model, one could compute the national average cost, but practically speaking, no one is proposing to rely on a national average result because, on average, there is no need for high-cost support. High-cost support is intended to target appropriately sized geographic regions that face unique cost characteristics.

¹⁸ In a report to the Vermont General Assembly, the Vermont Public Service Board included draft legislation that would define a high-cost area as one in which "the price of basic service to customers is in excess of 150 percent of the state average." Vermont PSB, Universal Service in a Competitive Era: A Report to the Vermont General Assembly by the Vermont Public Service Board (January 1996), Attachment: Draft Legislation, at 3. The rate would include dial tone, the end user common line charge, and average local measured service charges. Id. at 64 n.141.

¹⁹ Cal. P.U.C. R.95-01-020/I.95-01-021, released October 25, 1996.

of providing the basic service.²⁰ Throughout this proceeding, TW Comm has proposed that costs be compared to an affordability benchmark, which combines some of the attributes of a rate-based benchmark with those of a revenue-based benchmark. TW Comm also concurs with the Joint Board that the use of a benchmark that is tied to the average cost is ill-advised because it fails to reflect the revenue side of the USF equation.²¹

TW Comm agrees that, of the three alternatives identified by the Joint Board, the use of average revenues-per-line²² – assuming that all appropriate revenues are encompassed by the threshold – is the most economically efficient and fair mechanism for making the initial cut at establishing the need for and level of high-cost support.²³ Such a mechanism recognizes that both sides of the universal service equation must be considered – the cost of providing basic local exchange service and the relevant revenues that are inextricably linked with the

²⁰ Id. at para. 315.

²¹ Recommended Decision at para. 317.

²² The Joint Board proposes that benchmarks be set separately for determining residential and business high-cost support. Id. at para. 312.

²³ The actual revenues received from customers in the relevant geographic area and the income level in that area should also be considered before any funds are actually awarded for USF support.

provision of such service.²⁴ Even if the entry-level rate for basic local exchange service (stripped of all discretionary charges for usage, vertical services and other elements) is less than the cost of providing such service, the revenues yielded by services such as call waiting, caller ID, and other discretionary services – when combined with the basic local exchange rate – are likely to exceed the combined cost of providing these basic and discretionary services.²⁵ The use of total per-line-revenues also has the virtue of avoiding the effects of variations in local/intrastate rate structures. For example, basic exchange service rates in jurisdictions that have implemented local/toll rate rebalancing²⁶ will (all other things being equal) tend to recover a larger fraction of cost – or perhaps even all of it – than they will in states in which toll and access charges continue to provide a major source of revenue and contribution.²⁷

Using a benchmark revenue level to offset high-cost support requirements also should satisfy the important attribute

²⁴ See Chapter 7 of NCTA Comments, Attachment A, Susan M. Baldwin and Lee L. Selwyn, The Cost of Universal Service: A Critical Assessment of the Benchmark Cost Model (April, 1996).

²⁵ The incremental cost of providing most vertical central office features, such as call waiting, touch tone calling, and caller ID is either zero or negligible.

²⁶ See e.g., California, Massachusetts and Illinois.

²⁷ See e.g., Texas and Maine.

of operating in a competitively-neutral manner. For example, a new, facilities-based entrant and the ILEC are presumed to have comparable forward-looking incremental costs to serve a high-cost region and, based upon competitive market conditions, can command comparable revenues from discretionary services. Therefore, with a properly implemented revenue-based benchmark, the facilities-based new entrant will be on an equal footing with the ILEC.

The remainder of this section will address the following issues that the Commission must consider in order to implement a workable revenue benchmark:

- A) including all revenues inextricably linked to basic telephone service within the revenue benchmark;
- B) computing two distinct revenue-based thresholds to recognize ILECs' unique access to revenues from yellow pages;
- C) choosing a national or a state benchmark only after considering the manner in which the burden of high-cost support is to be spread;
- D) assessing the relative merits of freezing the revenue benchmark; and
- E) other criteria that should be used to target carefully the distribution of high-cost support.

A. All revenues inextricably linked to basic telephone service should be included within the revenue benchmark.

The Commission should explicitly require that the revenues included in the computation of a revenue-based benchmark for high-cost funding purposes reflect all revenues that are inextricably linked with basic telephone service. The RD recognizes this principle, but does not explicitly identify all services that would meet this guideline.²⁸ The RD does recognize that access revenues are inextricably linked.²⁹ Thus, the revenue calculation should include imputed switched access revenues for all toll demand (whether the toll is basic "message toll service" ("MTS") or an optional toll calling plan). Including imputed switched access revenue for all toll demand would be competitively neutral and would also address (1) the enormous variety in local calling areas from state to state³⁰ and (2) the wide range of progress in rate rebalancing among the various state jurisdictions.

²⁸ Recommended Decision at para. 310.

²⁹ Until such time as intraLATA presubscription has been fully implemented, the entire toll revenue should be included.

³⁰ Furthermore, there are numerous "optional" calling packages that could be construed as either local calling plans, toll plans, or a combination of both.